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THE URUGUAY ROUND

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Investment Measures

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The following communication dated 14 March 1990 has been received by the Secretariat with the request that it be circulated to the Group.

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SECTION I

Introduction

1. The clear intent and operative thrust of the Punta del Este declaration on Trade-Related Investment Measures was to focus on the trade restrictive and distorting effects of investment measures. It was neither the intention to establish an international investment régime nor to circumscribe the capacity of governments to employ investment measures per se. Participants accepted the negotiating mandate which they regarded as being carefully balanced and as permitting an examination of those investment measures which have a direct and significant adverse effect on trade. It is in order to facilitate the work of the Negotiating Group and to secure a pragmatic and realistic outcome that this submission is being made.

2. The "mid-term" decision on Trade-Related Investment Measures not only reaffirmed the above-stated understanding of the original mandate, but also stipulated that development aspects should be integrated into the negotiating process. It is, therefore, our intention to attempt a comprehensive listing of development considerations and such other considerations relevant to the work of the Group.

## SECTION II

### Need to deal with effects and not measures

3. Investment measures are employed by governments in the broader context of social and economic policy objectives. The need to employ such measures arises from development considerations. As already indicated in Section I paragraph 1 above, the mandate clearly requires an examination of the direct and significant adverse effects, if any, of investment measures. Before consideration is accorded to "further provisions that may be necessary to avoid such adverse effects on trade" in the context of "an examination of the operation of GATT Articles related to the trade restrictive and distorting effects of investment measures", the alleged direct and significant adverse effects must be demonstrated. This methodological prerequisite stipulates that:

- (i) there can be no a priori presumption that investment measures are inherently trade restrictive and distorting;
- (ii) if it were demonstrated in the Group that, in certain circumstances and on a case-by-case basis, some of the investment measures cited by participants do indeed have a direct and significant trade restrictive and distorting effect, in the sense of being adverse<sup>1</sup>, a clear causal link would need to be established between the measure and the alleged effect.
- (iii) if the adverse effect were demonstrated, assessment as to its nature and impact on the interests of the affected party would have to be undertaken;
- (iv) if the sequential steps outlined in (i) to (iii) above are undertaken and the Group feels that, in certain circumstances, a particular investment measure does indeed have a direct and significant adverse effect on trade, then appropriate ways and means have to be found to deal with the demonstrated adverse effects;
- (v) following from (iv) above, clearly it is the effects and not the measures themselves that need to be addressed.

4. Any suggestion that investment measures themselves, including incentives, should be prohibited is not only inappropriate but unrealistic and unacceptable. The General Agreement does not prohibit even dumping and subsidization and only provides for remedies/countermeasures under certain circumstances.

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<sup>1</sup>It can be demonstrated that some investment measures, alleged to be trade restrictive and distorting, in fact have an overall beneficial impact, as has been stated in MTN.GNG/NG12/W/18.

### SECTION III

#### Development aspects

5. Investment measures are employed by governments in the broader context of development policy, foreign capital treatment, industrialization policy and balance-of-payments reasons. Such measures are employed by governments as important instruments for the attainment of social and economic policy objectives consistent with the provisions of the General Agreement, particularly as elaborated in Part IV of the General Agreement, when contracting parties, inter alia,

(i) recalled that the basic objectives of the Agreement include the raising of the standards of living and the progressive development of the economies of all contracting parties; and

(ii) considered that the attainment of these objectives is particularly urgent for less-developed contracting parties.

Additionally, it is recognized in the General Agreement that "economic development is consistent with the objectives of the General Agreement, and that the raising of the general standard of living of the under-developed countries which should be the result of economic development will facilitate the attainment of the objectives of the Agreement."

6. In pursuance of the general objectives stated above, governments employ investment measures in the context of their programmes and policies to promote socio-economic growth and development by, inter alia:

- ensuring the most efficient and fullest contribution of investments to the national economy;
- enhancing and maximizing employment opportunities;
- facilitating restructuring under socially acceptable conditions;
- eliminating industrial, economic and social disadvantages of specific regions;
- diversifying and expanding economic activities;
- alleviating pressures on available foreign exchange and making the fullest and most efficient use of it in the context of the conditions of their external sectors;
- ensuring the most effective use of natural resources and value-added contributions to the economy;
- expanding export markets;
- ensuring adequate supply of certain products for the needs of local markets;
- enhancing the contribution of investments to building and upgrading domestic technological capability;

- encouraging research and development programmes; etc.

7. The nature of the objectives described above makes it clear that governments need to retain the flexibility and autonomy to employ investment measures to attain the larger objectives of the General Agreement.

#### Additional considerations

8. In addition to the imperatives of development, outlined above, there are considerations which create the need for governments to employ investment measures in order to offset the trade restrictive and distorting effects of corporate practices and behaviour. Some illustrative examples of these measures are set out below. It may be mentioned that whilst they are employed to secure developmental objectives, they also in some cases simultaneously address the adverse impact of certain forms of corporate behaviour which would otherwise undermine such objectives. The illustrative listing below, both of development considerations and of additional considerations, clearly demonstrates that many of the investment measures cited, such as local equity, remittance and other exchange restrictions, technology transfer and licensing, do not have any relationship with or impact on trade. There are, in a second category, some investment measures which, though trade-related, do not have a direct and significant adverse trade effect. Those that may have direct and significant trade effects have beneficial effects for economies and hence are justified on development considerations.

(i) Local content requirements (LCRs) - Apart from the objective of encouraging the use of locally available inputs and thus promoting the process of domestic industrialization, LCRs are most often a response by host country governments to vertically integrated corporate enterprises holding a dominant position of market power, which might prefer to source components and parts from parent companies or foreign sources even if comparable imports are locally available. By limiting the scope for transfer pricing and differential or predatory pricing by the foreign enterprise, LCRs also strengthen the corresponding market power of the producers of domestic inputs against such practices by foreign suppliers aimed at eliminating local production. LCRs are also designed to meet requirements of rules of origin, as for example, under GSP schemes.

(ii) Manufacturing requirements - Such measures, apart from encouraging domestic production/manufacturing capacity, are designed to counter international market allocation by ensuring corresponding market power for local producers/manufacturers who might otherwise be eliminated by unfair foreign competition. These measures are also used by host country governments either to avoid abusive pricing practices by corporate enterprises (e.g. as in pharmaceuticals) or to protect local firms from predatory practices.

(iii) Domestic sales requirements - Such measures which require the foreign investor to sell in the domestic market, are intended to ensure that certain products are available in the host country in sufficient quantities and at appropriate prices for the needs of the local market. Often, such measures are necessary to counteract the corporate entities' refusal to deal or unfair (cartel) pricing. In the absence of such measures, domestic firms may be forced to import such products at exorbitantly high prices.

(iv) Trade balancing requirements - Stipulations to the effect that an investor import only a specified amount or proportion of the value of his exports, or that he balance the value of his imports and exports are employed essentially by governments facing foreign exchange difficulties. Such measures, like local content and export requirements, are aimed at limiting the net outflow of foreign exchange. They also strengthen the position of domestic producers, thereby enabling them to combat international market allocation arrangements within and among foreign firms, long-term exclusivity contracts or tied-selling arrangements.

(v) Remittance and other exchange restrictions - Limitations on the outflow of profits and other remittances are mainly aimed at reducing pressures on the balance of payments of host countries.

(vi) Local equity requirements - Specification that a certain percentage of the equity of a company created by foreign investment be held or created by local investors is aimed at ensuring a degree of control for local management. Such measures also encourage local savings and transfer of technology and may also be necessary for reasons of national security.

(vii) Product mandating requirements - This requirement counters enterprise-to-enterprise market allocation or exclusivity contracts by earmarking specific product(s) for export. Such measures are also employed to take advantage of market opportunities, such as trade preferences, etc.

(viii) Export performance requirements - Since foreign investments necessarily involve obligations for repayments, countries may wish to reduce pressures on demands for foreign exchange by stipulating export requirements in relation to such investments. In addition, such measures may stem from an effort by governments to counter international market allocation by foreign enterprises which may restrain or block exports from a given country. Similarly, a corporate enterprise may allocate markets among subsidiaries with the sole aim of securing access to a given market through the opening of a local production subsidiary, with no intention of exporting from the new manufacturing base. Such measures are, therefore, a means for host country governments to curb export prohibitions at the enterprise level and also help to ensure quality products for competition in world markets.

(ix) Technology transfer and licensing requirements - The basic objective of such measures is to acquire the advanced technology that is so important for development. They are also used to strengthen the bargaining position of the host country in international contract negotiations. Requests for a technology unrelated to the proposed project but of value elsewhere in the economy, or other licensing requirements, are part of the bargaining process of the host country aimed at strengthening the position of domestic firms in contract negotiations with foreign enterprises.

#### SECTION IV

##### GATT Articles

9. The negotiating mandate of Punta del Este, as reaffirmed by the "mid-term" decision, requires "an examination of the operation of GATT Articles related to the trade restrictive and distorting effects of investment measures, ...". Regrettably, the Group appears to have overlooked certain basic premises on which the General Agreement, a multilaterally negotiated legal instrument with a carefully defined set of rights and obligations, is established, such as:

(i) The GATT, as presently structured, is designed to deal with international trade in goods, as they cross international frontiers;

(ii) GATT has, therefore, traditionally undertaken trade liberalization endeavours embodying border measures such as tariffs and non-tariff measures;

(iii) Investment measures are, by definition, imposed not at the border but at the point of production;

(iv) To the extent that measures enforced at the point of production deal with acts of importation or exportation (already accomplished or sought to be accomplished), establishment of the link between measures imposed at the border and at the point of production involves complex difficulties;

(v) To the extent that investment measures have an adverse effect in the realm of trade which is direct and significant, such effects need to be demonstrated. The manner in which the measure in question causes nullification and/or impairment of benefits accruing to a contracting party would need to be demonstrated in accordance with the normal procedures of the General Agreement;

(vi) The existing framework of GATT rights and obligations, providing as it does for remedies in the event of nullification and/or impairment of benefits, would appear to be sufficient to deal with alleged adverse effects of some of the investment measures cited in the Group thus far;

(vii) Should participants be able to demonstrate that some of the investment measures have adverse effects of a direct and significant nature over and above those foreseen in the framework of rights and obligations under the GATT, consideration would then have to be given by the Group to search for ways and means to remedy such adverse effects.

10. As already indicated above, a satisfactory and acceptable outcome of the work of the Group would appear to lie in an approach which is proportionate to the magnitude of the problem.

#### SECTION V

##### Conclusions and recommendations

11. All participants must endeavour to work towards a successful outcome in the negotiations on trade-related investment measures. The negotiated outcome should facilitate a movement of investments across international frontiers, especially with a view to serving developmental aspirations of developing countries. To prohibit the employment of investment measures per se would only have the effect of undermining and thwarting investment opportunities. In view of this, it is suggested that:

(i) in the spirit of the "mid-term" decision, modalities be discussed for avoiding the adverse trade effects of investment measures, where it is demonstrated that such trade effects are direct and significant;

(ii) the negotiation of such modalities should take place only in the context of identified and demonstrated adverse trade effects and within the existing framework of rights and obligations under the GATT;

(iii) the process of addressing the direct and significant trade effects, if any, should not be designed to create rights for investors but, rather, to remove distortions and impediments to international trade while serving the developmental interests of developing countries.

(iv) negotiations on TRIMs should take into account the concerns of least developed countries as expressed, inter alia, in document MTN.GNG/NG12/W/21.